BOSTON AND MAINE CORPORATION

FIRST ANNUAL REPORT 1964

// name formerly
Boston and Maine Railroad

THOROLD S. CURTIS

TREASURER
BOSTON AND MAINE CORPORATION

150 CAUSEWAY STREET
BOSTON, MASS. 02114

BOARD OF DIRECTORS

OLIVER D. APPLETON, Mount Kisco, N. Y.
JAMES A. ARDOLINO, Medford, Mass.
ANDREW J. BECK, Presque Isle, Maine
DANIEL A. BENSON, Marblehead, Mass.
MAYNARD W. BULLIS, Boston, Mass.
ANTHONY R. CATALDO, Lexington, Mass.
W. EARLE GOSS, Franklin, N. H.
EMMET J. KELLEY, Berlin, N. H.
EDWARD KROCK, Brookfield, Mass.
PATRICK J. MULLANEY, Winchester, Mass.
JOHN N. NASSIKAS, Manchester, N. H.
RALPH W. PICKARD, Boston, Mass.
FRANCIS J. REARDON, Lexington, Mass.
SAMUEL RESNIC, Holyoke, Mass.
GEORGE H. SEAL, Marblehead, Mass.
LEE P. STACK, Hingham, Mass.
ALFRED SWEENEY, Auburn, Maine
JAMES C. WEMYSS, JR., Groveton, N. H.

Executive Committee—Chairman: MR. APPLETON; Members: MESSRS. BENSON, CATALDO, KROCK, PICKARD, REARDON, RESNIC, and SWEENEY.

Finance Committee—Chairman: MR. STACK; Members: MESSRS. BENSON and SEAL.

OFFICERS

DANIEL A. BENSON, President and Chief Executive Officer
RALPH W. PICKARD, First Vice President
PATRICK J. MULLANEY, Vice President-Traffic
WILFRED H. HOLLAND, Vice President-Operations
E. FRANKLIN REED, Vice President-Industrial Development
THOROLD S. CURTIS, Treasurer
MAYNARD W. BULLIS, Secretary
PAUL C. DUNN, Chief Mechanical Officer
WHITCOMB HAYNES, General Manager
CHARLES F. YARDLEY, General Manager-Piggyback

TRANSFER AGENTS

Old Colony Trust Company, 45 Milk Street, Boston
Manufacturers Hanover Trust Company, One Whitehall Street, New York

As of March 1, 1965

DANIEL A. BENSON

President's Report

In 1964 the Boston and Maine cleared the major roadblocks that had been impeding its long standing efforts to eliminate the passenger deficit. The effect of this accomplishment on the Corporation's financial position will be reflected in the coming year.

The deficit has persisted for 19 consecutive years. It has been one of the major impediments in the Corporation's efforts to achieve financial recovery. For the year 1964, it was one of two factors that accounted for over 90% of the consolidated net loss of $5,257,745.

The passenger net railway operating deficit alone was $3,252,827 despite the benefit of $322,308 in payments received from the Mass Transportation Commission in the first three months of 1964. As a result of wage and benefit settlements reached with railroad brotherhoods during the year, costs of $1,543,000 were incurred in back-time wage awards, adjustment of vacation accruals and firemen's severance payments.

The payments to firemen, which amounted to $277,000 will not recur. Instead, discontinuance of these jobs will result in future savings.

Principal events of 1964 that will have significant effect on the Boston and Maine's future prospects were these:

PASSENGER SERVICE

Major efforts were initiated in the first week of 1964 to end the Boston and Maine's long standing losses from passenger service.

A petition to discontinue all intrastate passenger service in Massachusetts to and from Boston was filed with the Massachusetts Department of Public Utilities on January 6, 1964. When the Department did not rule on the petition within the 120-day period prescribed by statute, petitions for discontinuance of all passenger service in and out of Boston were filed with the Interstate Commerce Commission.

In mid-year, the Massachusetts Legislature passed a mass transportation act establishing the Massachusetts Bay Transportation Authority. In part, the act empowered the Authority to subsidize commuter carrying railroads in the Boston area for a minimum period of three years.

Hearings on the B&M petitions were held by the Interstate Commerce Commission throughout the month of October in Boston and two cities in New Hampshire.

On December 14, 1964, the Boston and Maine signed a contract with the Massachusetts Bay Transportation Authority providing for B&M passenger service to 23 Massachusetts cities and towns for a period of three years at an annual subsidy that will enable operation of this service on a fully compensatory basis. At the option of the Authority, the contract could be extended on the same basis for an additional period of two years.

On December 31, 1964, the Interstate Commerce Commission issued an order on the Boston and Maine's petition for discontinuance of interstate passenger service to and from Boston. The order authorized the Boston and Maine to discontinue immediately all but three round trips of trains that had formerly operated in interstate service, at the same time stipulating that these three round trips could be discontinued after 60 days. Subsequently, the Commission issued another order discontinuing all B&M passenger service within Massachusetts in and out of Boston. This order materialized after the Boston and Maine had entered into a contract with the Massachusetts Bay Transportation Authority, assuring continuance of passenger service within the MBTA area.

THE MBTA CONTRACT

The principal features of the Boston and Maine's contract with the Massachusetts Bay Transportation Authority are these:

I—The contract is to run for three years, subject to annual review by the MBTA. At the option of the MBTA, the contract could be extended for an additional period of two years.

II—Annual payments to be received by the railroad will represent essentially the difference between the costs of providing the service and the revenues derived from the service.

III—Levels of train service and fare structures are to be determined by the MBTA.

IV—The MBTA has the right to lease or purchase B&M Budd cars that may become surplus to requirements of B&M passenger service within the MBTA district. Any purchase of such equipment by the MBTA would be at the fair market price.

V—In the event that the MBTA should request cancellation of the contract, or in the event the MBTA should discontinue subsidy payments, the Boston and Maine would, except for two round trips on it's Connecticut River lines, be entirely relieved of its passenger operations without the necessity of filing passenger discontinuance petitions before state or federal agencies.

FREIGHT SERVICE

Consolidated freight revenues of $53,541,-800 for 1964 declined slightly from $53,566,-319 in 1963.

These results were accomplished despite the recurrence of national railway strike threats on three separate occasions during the year. Historically, such threats result in diversion of traffic from railroads to other transportation modes, and in many cases it is virtually impossible to recover such business.

An additional handicap that had to be overcome was the occurrence of strikes in nine plants served by the Boston and Maine. Traffic volume derived from these plants represents more than 900 cars per month. Paper companies, which are among the Boston and Maine's most substantial shippers, sustained strikes lasting from two months in one case to more than five months in another.

Despite these setbacks, revenues showed distinct signs of recovery in the concluding months of 1964. In the last four months of the year, consolidated operating freight revenues were $18,054,999 as compared with $17,450,-407 for the like period of 1963, an increase of $604,592.

The policy of preserving business by reducing rates to encourage heavier shipments has resulted in material increases in average loads per car. The Boston and Maine continued to handle large volumes of concrete aggregates into the Boston area, all in multiple-car lots. Large public utilities served by the Boston and Maine are now receiving all their coal in solid trainloads. Commodities, such as salt and cement, are also moving in multiple-car lots.

Like most other eastern railroads, the Boston and Maine has now completely eliminated the hauling of less-than-carload freight except that which can be moved to and from private sidings without railroad handling.

As in the case of passenger business, revenues derived from the handling of less-than-carload freight had long ago proved to be inadequate to cover the costs of providing this service and hence had resulted in a deficit operation.

PIGGYBACK SERVICE

Rising trends in revenues and volume that have marked piggyback traffic in the years since its inception continued in 1964.

A total of 30,038 loads were handled in 1964, an increase of 11.8% over the 26,860 loads handled in 1963.

Revenues increased from $2,473,992 in 1963 to $2,897,379 in 1964, a rise of $423,387 or 17.1%.

At the same time, the purchase of 200 new trailers in 1963, together with renegotiation of equipment leases in that year, enabled the Piggyback Department to hold the line on its

operating expenses in 1964. Total direct expense for the year was $1,960,248 as compared with $2,020,130 in 1963.

EQUIPMENT RENTALS

For the third consecutive year, reductions were achieved in net rents for equipment and joint facilities.

Net costs for 1964 were $5,415,894, a decrease of $765,752 from the 1963 costs of $6,181,646.

IMPROVEMENTS

Capital expenditures for equipment and road property in 1964 were $2,970,005.

Stone ballast was applied to 14 miles of main line track and 251 single track miles of stone ballasted main track were resurfaced. New and relay rail laid during the year totaled 1,200 tons, while 35,000 cross ties, new and relay, were installed during the year.

The Signal Department completed installation of new CTC between Holyoke, Massachusetts, and Windsor, Vermont, a total of 84.75 road miles.

New work equipment and roadway machines purchased during the year are capable of renewing 50 to 60 ties per hour and straightening surface-bent rail ends at the rate of one mile of track per day. Three multiple tampers were rebuilt and adapted to automatic operation. Approximately 250 miles of track have been resurfaced with these units at a rate of 800 to 1,000 feet per hour.

INDUSTRIAL DEVELOPMENT

Companies located on the Boston and Maine completed a total of 814,000 square feet of new plant and warehouse construction, as well as expansion of existing facilities, during 1964. When in full operation, these industries are expected to yield upwards of 8,800 cars of freight annually. New track installation to serve these plants involves about 14,100 lineal feet of trackage.

Some 620,000 additional square feet of buildings to accommodate 14 concerns, are under construction or in final planning stages. These concerns will require track service and are expected to produce substantial rail freight volume.

Notable progress has been made in the location of new industries in the Peabody, Massachusetts, Industrial Park which until recently had lagged in site sales. Of the 92 acres in this industrial park, 67 will be occupied by 11 manufacturing firms with an investment of $6,500,000 in land and buildings. A new lead track, 3,000 feet long, was completed into the Peabody park, and spur tracks have been constructed to serve the new Bicknell and Fuller 90,000 square foot manufacturing plant and the new 110,000 square foot building of Stern Can Co.

Two new buildings, totaling 217,000 square feet, were completed at the North Circle Industrial Park, North Leominster, Massachusetts. Tracks have been installed to serve Rand-Whitney Co. and Selig Manufacturing Co.

The sale of a parcel of more than five acres in the Lechmere Project Area, East Cambridge, Massachusetts, will permit demolition of two antiquated freight houses and construction of an ultimate 100,000 square feet

of new warehouse space expected to produce an additional 1,000 cars of freight per year.

LONG-TERM DEBT CHANGES

The Boston and Maine met substantial obligations for equipment and road property in 1964. This resulted in a net reduction in long term debt of $3,182,564, as reflected in the following table:

Balance at beginning of year	$92,821,807
Increases:	
Equipment and Road Property obligations for new acquisitions	1.610,751
	$94,432,558
Decreases:	
Equipment and Road Property obligations paid	3,467,164
Principal payments made on Collateral Trust Indentures	366,667
Series SS 6% Bonds paid off and retired (Annual Serial Maturity)	959,484
	4,793,315
Balance at end of year	$89,639,243

BONDS MODIFICATION PLAN

Discussions were begun during the year with major institutional holders of the Boston and Maine's First Mortgage Bonds, Series SS, 6%, in the amount of $44,136,264, due August 1, 1965, with a view towards development of a plan for the extension of these maturities, as well as the Series AC, 5%, in the amount of $2,424,000, due September 1, 1967. Preliminary steps for the refunding of these maturities have been completed, and a plan calling for an extension is now awaiting a decision of the Interstate Commerce Commission.

CORPORATE CHANGES

In accordance with the vote of the stockholders at the 1963 annual meeting, the Boston and Maine Railroad, formerly incorporated in the States of Massachusetts, Maine, New Hampshire, Vermont, and New York, was merged, effective April 30, 1964, into the Boston and Maine Corporation, organized under the laws of the State of Delaware and as such being the surviving corporation. In connection with this merger no exchange of stock certificates was required.

In acting upon a listing application of the Corporation, the stock exchanges of New York and Boston required that the new Corporation present its accounts in annual reports to stockholders on a consolidated basis.

Accordingly, for comparison with 1964, accounts of 1963 have been restated in this report on a consolidated basis.

TAXES

Taxes aggregated $4,917,305 in 1964, as compared with $4,821,164 in 1963, an increase of $96,141, due principally to an increase in property taxes resulting from the continuing rise in tax rates assessed by cities and towns.

Federal income taxes in 1964 amounted to $32,393 and consisted of taxes on leased line rentals. These taxes decreased by $135,377 from the $167,770 incurred in 1963, due substantially to final settlement of the 1946 Northern Railroad income tax refund award

of a Federal District Court. The tax refund and interest totaled $225,206. It was paid by the Government in 1964 and remitted to the Boston and Maine under the terms of the lease with the Northern Railroad.

Payroll taxes for employee retirement, unemployment and sickness benefits amounted to $2,445,466 in 1964, compared with $2,434,-461 in 1963, a net increase of $11,005. The 1963 figure reflected an increase, effective November 1963, in the taxable amount per employee from $400 to $450 a month for two months only. The 1964 figure reflects this increase for the full year.

Changes in taxes are shown in the following table:

	1964	*1963*
State and Municipal	$2,366,462	$2,143,057
Federal Payroll	2,445,466	2,434,461
Federal Income	32,393	167,770
Other	72,984	75,876
Total	$4,917,305	$4,821,164

RAILROAD MERGERS

In 1962, management of the Boston and Maine met with top officials of major eastern railroads that had signalled their intention to pursue merger efforts in applications to the Interstate Commerce Commission. The Boston and Maine management discussed with these railroads a study to explore the feasibility of establishing a New England railroad system.

In response to this approach, the major carriers inquired as to the Boston and Maine's plans for dealing with its large and persistent passenger deficit. They also inquired as to the Boston and Maine's prospects of refunding its First Mortgage debt maturities, the largest portion of which was due in August, 1965.

By early 1963, the Interstate Commerce Commission had before it petitions for merger from the Norfolk and Western and Nickel Plate Railroads on the one hand and the Pennsylvania and New York Central Railroads on the other. The Boston and Maine participated in hearings on both cases before the Commission.

As has been reported to the stockholders, the suggestion advanced by the Boston and Maine management in 1962 resulted in a subsequent study by the Pennsylvania, New York Central, Norfolk and Western, New Haven, and Boston and Maine. No final conclusions were reached.

On June 24, 1964, the Interstate Commerce Commission approved the merger of the Norfolk and Western and Nickel Plate Railroads. The merged system was authorized to lease the Wabash Railroad for a period of eight years, and to acquire control of that railroad through the purchase of stock.

In the Norfolk and Western-Nickel Plate decision, the Commission stipulated that the Boston and Maine, among other railroads, can petition for inclusion in this new system within a period of five years. To qualify for consideration, the Boston and Maine would have to meet financial criteria that, until the developments of 1964, appeared difficult to accomplish.

It is anticipated that the Commission may act during the coming year on the pending

application for merger of the Pennsylvania and New York Central Railroads. These two railroads have indicated that to facilitate the Commission's determination of their application they would be prepared to enter into an arrangement for operation of the New Haven's freight service.

These developments, accomplished and projected, are of great significance to security holders of the Boston and Maine.

In light of the Interstate Commerce Commission's decision in the Norfolk and Western-Nickel Plate case, and the considerations that will have to be weighed by the Commission in the Pennsylvania-Central case, it is apparent that the concept of a New England railroad system cannot be pursued with any expectation of realization.

The future of the Boston and Maine, therefore, must be assessed in terms of the Commission's ruling in the Norfolk and Western-Nickel Plate case, as well as the outcome of the Pennsylvania-New York Central application.

The first and most decisive change in the Boston and Maine's prospects was the Interstate Commerce Commission decision authorizing discontinuance of passenger service and the contract with the Massachusetts Bay Transportation Authority. The second important development was the negotiation with major institutional bondholders for a refunding of First Mortgage debt maturities due in 1965 and 1967. The result of these negotiations was that, subject to certain conditions, an extension of the maturities would be favorably considered by the major bondholders.

The Boston and Maine management has assured the bondholders that it will make every effort to satisfy the conditions set forth in the negotiations and thereafter devote itself to achievement of a financial position that will enable it to seek inclusion in a major railroad merger on the most favorable terms possible for the interests of all Boston and Maine security holders.

EMPLOYEE RELATIONS

The year saw a number of changes in work rules applicable to various classes of organized railroad employees. Negotiations with both operating and non-operating unions were conducted on a national basis. They resulted in the elimination of certain jobs of locomotive firemen in freight and yard service, as well as elimination of certain yard switching assignments.

Savings to date have been offset to some degree by very liberal severance allowances to firemen affected by an Arbitration Board award.

Demands of train and engine service organizations for wage increases and certain fringe benefits were settled by agreement.

Non-operating employee organizations threatened strikes on several occasions when negotiations of their wage and job stabilization demands reached stalemates. At the end of the year, most of the demands had been settled by a three-step wage increase, increased holiday and vacation benefits and changes in the medical and insurance program.

A new factor in 1964 was the demand of

non-operating organizations for job stabilization agreements aimed at preventing reductions in the work force except by attrition. Agreement was reached nationally with three shop craft organizations in September and with the remaining organizations, shortly after the first of the year.

Both operating and non-operating organizations have agreed to a moratorium on further wage and rule changes that will be in effect until mid-1966 at the earliest.

In the first three months of 1964, when the third and final phase of the mass transportation demonstration program was conducted, the cooperation of all employees of the Boston and Maine was an important factor. A similar spirit was shown as the Boston and Maine prepared to undertake in 1965 its responsibilities under the contract with the Massachusetts Bay Transportation Authority. The Boston and Maine is grateful to its employees for their cooperation during the year.

THE ROAD AHEAD

The management of the Boston and Maine has been giving close and continuing attention to opportunities for reducing expenses. Substantial savings are expected to materialize as a result of the revised service that will operate under the contract with the MBTA. The savings should permit absorption of the additional costs incurred during the past year as a result of national settlements with labor organizations.

The MBTA contract has opened the way for other changes in operations that should enhance earnings prospects and permit further reductions in costs.

Plans for these changes, completed in 1964, are expected to enable the Corporation to achieve major strides toward financial recovery in the coming year.

Daniel A Benson

ASSETS

	December 31 1964	December 31 1963
CURRENT ASSETS:		
Cash	$ 1,886,863	$ 2,691,854
Marketable securities, at cost (approximate market)	615,447	840,357
Special deposits	125,979	142,525
Accounts and notes receivable	4,800,464	5,553,274
Inventories of materials and supplies, at cost	2,947,668	2,819,898
Prepayments and other current assets	480,857	539,281
TOTAL CURRENT ASSETS	$ 10,857,278	$ 12,587,189
PROPERTIES (NOTE 2):		
Roadway and structures, including improvements to leased properties—$11,196,023 in 1964, $11,142,641 in 1963	$181,477,664	$180,808,478
Equipment	72,982,313	74,483,291
	$254,459,977	$255,291,769
LESS:		
Depreciation of roadway and structures	(8,356,039)	(8,028,621)
Depreciation of equipment	(25,756,962)	(24,451,455)
	$220,346,976	$222,811,693
Miscellaneous physical properties, less depreciation—$293,549 in 1964, $401,392 in 1963	3,771,263	3,781,650
	$224,118,239	$226,593,343
INVESTMENTS AND OTHER ASSETS:		
Investments in leased lines (Page 13 and Note 1)	$ 3,567,943	$ 3,514,841
Other investments (Page 14)	2,567,439	2,530,299
Deposits with trustees for first mortgage bonds and equipment obligations	104,707	104,057
Other assets and deferred charges	2,196,033	2,569,449
	$ 8,436,122	$ 8,718,646
	$243,411,639	$247,899,178

BALANCE SHEET

LIABILITIES AND CAPITAL

	December 31 1964	December 31 1963
CURRENT LIABILITIES:		
Accounts payable	$ 9,746,794	$ 10,214,258
Accrued vacation pay	1,997,737	1,538,935
Accrued interest	1,434,332	1,499,190
State and local taxes	4,900,735	4,072,812
Estimated current portion of injury and damage claims	1,546,099	1,288,798
TOTAL CURRENT LIABILITIES (excluding long-term debt due within one year)	$ 19,625,697	$ 18,613,993
LONG-TERM DEBT DUE WITHIN ONE YEAR (Page 14):		
First mortgage bonds	$ –	$ 959,484
Equipment and other obligations	4,459,258	3,801,873
	$ 4,459,258	$ 4,761,357
LONG-TERM DEBT (Page 14):		
First mortgage bonds	$ 46,560,264	$ 46,560,264
Income mortgage bonds	18,703,500	18,703,500
Equipment and other obligations	19,916,221	22,796,686
	$ 85,179,985	$ 88,060,450
OTHER LIABILITIES AND DEFERRED CREDITS:		
Provision for disputed per diem charges (Note 4)	$ 10,712,326	$ 9,661,880
Provision for injury and damage claims	1,259,112	859,961
Accrued depreciation on leased property and liabilities to leased lines	4,013,966	3,835,122
Unearned interest accrued on income mortgage bonds	5,236,980	4,488,840
Other	1,640,288	1,210,156
	$ 22,862,672	$ 20,055,959
CAPITAL AND RETAINED INCOME		
Capital stock (Note 5):		
5% Preferred stock, $100 par value:		
Authorized—239,071 shares in 1964, 244,459 in 1963		
Issued (excluding 5,266 shares held in treasury in 1963)—239,071 shares in 1964, 239,193 in 1963	$ 23,907,100	$ 23,919,300
Common stock, $1 par value in 1964, no par value in 1963:		
Authorized—4,000,000 shares in 1964, 1,093,852 in 1963		
Issued (excluding 4,249 shares held in treasury in 1963)—589,570 shares in 1964, 589,311 in 1963	589,570	58,931,125
Additional capital (Note 5)	84,376,019	26,021,994
Retained income (Page 13 and Note 6)	2,411,338	7,535,000
	$111,284,027	$116,407,419
Contingent obligations and commitments (Note 8)		
	$243,411,639	$247,899,178

BOSTON AND MAINE CORPORATION AND CONSOLIDATED SUBSIDIARIES

STATEMENT OF INCOME

	Year ended December 31	
	1964	*1963*
OPERATING REVENUES:		
Freight	$ 53,541,800	$ 53,566,319
Passenger	5,270,323	5,007,997
Other (including subsidy received from Mass Transportation Commission—$322,308 in 1964, $2,021,032 in 1963)	4,561,537	6,494,192
	$ 63,373,660	$ 65,068,508
OPERATING EXPENSES:		
Transportation	$ 30,620,996	$ 30,059,269
Maintenance of way and structures	7,745,373	7,061,248
Maintenance of equipment	9,370,681	9,425,760
Traffic, general and miscellaneous expenses	5,237,706	4,521,234
	$ 52,974,756	$ 51,067,511
NET REVENUE FROM OPERATIONS	$ 10,398,904	$ 14,000,997
OTHER OPERATING CHARGES:		
Payroll, property and state excise taxes, etc.	$ 4,917,305	$ 4,821,164
Net rents for equipment and joint facilities	5,415,894	6,181,646
	$ 10,333,199	$ 11,002,810
NET OPERATING INCOME	$ 65,705	2,998,187
NONOPERATING INCOME (EXPENSE)—NET	17,343	(250,638)
NET INCOME BEFORE FIXED CHARGES AND CONTINGENT INTEREST	$ 83,048	$ 2,747,549
FIXED CHARGES:		
Rent for leased lines, etc.	$ 448,239	$ 453,938
Interest:		
First mortgage bonds	2,795,900	2,855,140
Equipment trust certificates	448,705	511,315
Conditional sale contracts	411,393	451,927
Guaranteed notes and other	389,056	496,946
Amortization of long-term debt discount and expense	99,360	92,958
	$ 4,592,653	$ 4,862,224
NET LOSS BEFORE CONTINGENT INTEREST	$ 4,509,605	$ 2,114,675
Contingent interest	748,140	748,140
NET LOSS	$ 5,257,745	$ 2,862,815

BOSTON AND MAINE CORPORATION AND CONSOLIDATED SUBSIDIARIES
STATEMENT OF RETAINED INCOME

	Year ended December 31 1964	1963
BALANCE AT BEGINNING OF YEAR	$ 7,535,000	$ 9,120,871
ADDITIONS (deductions) FOR THE YEAR:		
Net loss	(5,257,745)	(2,862,815)
Net gain on disposal of land	280,317	258,266
Losses on track retirements	(200,618)	(364,054)
Gain on sale of North Station Industrial Building Inc.'s properties	—	1,382,732
Other	54,384	—
BALANCE AT END OF YEAR	$ 2,411,338	$ 7,535,000

STATEMENT OF INVESTMENTS IN LEASED LINES
DECEMBER 31, 1964

	No. of shares owned	*% owned*	*Cost*	*Boston and Maine equity in book value of underlying net assets*	*Approximate value based on current market quotations*
Northern Railroad	20,370	66.4	$ 2,098,131	$ 2,092,666	$ 1,568,000
Stony Brook Railroad	1,814	60.5	149,935	188,436	120,000
Vermont & Massachusetts Railroad	11,647	36.5	1,319,877	2,044,356	943,000
			$ 3,567,943	$ 4,325,458	$ 2,631,000

The shares in leased line companies have been acquired over the period from 1937 to 1964. At December 31, 1964 all of the shares were pledged to secure long-term debt. Annual rentals of the leased lines, under long-term leases, amount to approximately $405,000 plus certain federal and state taxes of the leased line companies which currently aggregate about $200,000 per year. Dividends received from the leased line companies amounted to $200,000 in 1964 and $195,000 in 1963. Since the leased line companies distribute on a current basis substantially all of their net income as dividends, the book values of the underlying net assets of each company have remained approximately the same during the period Boston and Maine has acquired shares in the companies.

BOSTON AND MAINE CORPORATION AND CONSOLIDATED SUBSIDIARIES

STATEMENT OF LONG-TERM DEBT

DECEMBER 31, 1964

	Portion due: Within one year	Portion due: After one year (a)
FIRST MORTGAGE BONDS (b and c):		
Series SS, 6%, due August 1, 1965	$ —	$ 44,136,264
Series AC, 5%, due September 1, 1967	—	2,424,000
		$ 46,560,264
INCOME MORTGAGE BONDS, SERIES A, 4½% (4% cumulative), due July 1970 (d)	—	$ 18,703,500
EQUIPMENT AND OTHER OBLIGATIONS:		
Equipment Trust Certificates, Series 1, 4½% to 6% due March 1971 secured by equipment of an aggregate original cost of $23,490,000	$ 1,234,000(e)	$ 7,404,000
Guaranteed Notes 4¾% to 5% due 1965 to 1977 secured by $1,752,600 principal amount of Series SS bonds, capital stock of leased lines, capital stock and notes of certain wholly-owned subsidiary companies and "other investments" carried at cost of $2,009,794	941,667	6,500,000(f)
Conditional sale contracts and mortgage notes maturing at various dates from 1965 to 1990, secured by equipment and real estate of an aggregate original cost of $27,637,000	2,283,591	6,012,221(f)
	$ 4,459,258	$ 19,916,221
		$ 85,179,985

(a) Amounts outstanding are exclusive of bonds owned by the companies—$1,752,600 of Series SS bonds pledged against guaranteed notes, $641,000 of Series AC bonds held by the first mortgage trustee, and $559,000 of income mortgage bonds which are unpledged.

(b) The first mortgage bonds are secured by substantially all the road properties and equipment of the company, its operating franchises, leases and agreements subject to the prior lien of equipment trust obligations and conditional sale contracts in the case of certain property and equipment as indicated in the statement above. Interest is payable semiannually at the indicated rates for the two series. The Series SS bonds mature on August 1, 1965.

(c) With respect to the Series SS and AC first mortgage bonds, the company has pending before the Interstate Commerce Commission an application for approval of a refunding plan for submission to bondholders, which provides for the exchange of new First Mortgage bonds, Series TT, 6%, due August 1, 1968, in the same principal amount. The proposed plan further provides for a maximum annual sinking fund payment, beginning in 1966, equal to 1% of the outstanding Series TT bonds, if the company's "net income", as defined in the application, is sufficient.

(d) The income mortgage bonds are secured by a second mortgage on the same properties as those securing the first mortgage bonds. Interest is payable at the rate of 4½% per annum if "available net income" is sufficient and, if not earned, is cumulative and payable not later than the maturity of the bonds at the rate of 4% per annum. The income mortgage bonds are entitled to the benefit of a sinking fund provision under which the company is required annually, on or before September 1, to deposit with the trustee $483,000 in cash or Series A bonds (at the lesser of their principal amount plus accrued interest, or their cost to the company) if "available net income" is sufficient. There has been no sinking fund obligation since 1958.

(e) The same amount matures within each subsequent year to maturity.

(f) Payable at varying amounts each year to maturity.

NOTES TO FINANCIAL STATEMENTS

Note 1—Basis of Consolidation

The accompanying financial statements include the accounts of Boston and Maine Corporation (formerly Boston and Maine Railroad) and those of its wholly-owned subsidiary companies. The accounts of the subsidiaries have been consolidated for the year 1964 and for comparative purposes the amounts shown for 1963 in the accompanying financial statements have been restated to include the accounts of the wholly-owned subsidiaries. The restatement increased previously reported retained income and additional capital at December 31, 1963 by $224,861 and $132,000, respectively, and decreased the net loss for 1963 by $8,899. The company's investments

in unconsolidated leased line companies which are less than wholly-owned are summarized on page 13.

Note 2—Properties

The amounts shown in the balance sheet for properties represent, for the most part, the aggregate of acquisitions and additions (by merger, purchase, construction or otherwise), less retirements, recorded under the system of accounting prescribed by the Interstate Commerce Commission. In accordance with such accounting requirements the company commenced providing for depreciation on roadway and structures (other than properties such as rail, ties, ballast and other track materials) on January 1, 1943. The cost of equipment has been subjected to a systematic policy of depreciation since it was acquired. The recorded cost, less salvage, of all depreciable properties retired is charged to the depreciation reserves.

With respect to rails, ties, ballast and other track materials, included in the roadway accounts in the amount of approximately $39,300,000 at December 31, 1964, the company follows the prescribed practice of "replacement" accounting. For many years this accounting practice has been considered an acceptable alternative in the railroad industry to the more widespread practice of depreciation accounting. Under this practice replacements in kind are charged to maintenance expense and only improvements and additions are capitalized. The amounts capitalized are not depreciated. Retirements of such properties, less salvage, are also charged to maintenance expense, except that in recent years certain retirements which were considered abnormal have been charged direct to retained income. Gains and losses on disposals of land are credited or charged to retained income.

The accompanying statement of income includes charges for depreciation totaling $4,591,000 in 1964 and $4,651,000 in 1963.

Note 3—Federal Income Taxes

As of December 31, 1964, the companies had loss carryovers for federal income tax purposes aggregating approximately $50,000,000 which would be available to apply against income in varying amounts through the year 1971.

Note 4—Provision for Disputed Per Diem Charges

The company is party to a dispute with other railroads over per diem rates for car rentals. For various reasons, including its situation as a so-called terminal line, the company incurs more rentals than it earns. For several years payment has been made to other railroads at rates which are less than the rates adopted by the Association of American Railroads although full provision has been made on the books at the adopted rates, all by charges against income. The excess of amounts thus provided for on the books amounted to $10,712,326 as of December 31, 1964. The excess of amounts accrued and charged to income over payments amounted to $1,050,446 in 1964.

Note 5—Capital Stock, Stock Options and Additional Capital

Pursuant to the agreement of merger of Boston and Maine Railroad into Boston and Maine Corporation the authorized common stock was increased to 4,000,000 shares and each share of Railroad common stock, no par value, was converted into one share of the Corporation's common stock, par value $1 per share and the Railroad's 5% preferred stock, $100 par value, was converted share for share into 5% preferred stock, $100 par value, of the Corporation. As a result of the conversion, common stock was reduced and additional capital increased during 1964 by the $58,341,814 excess of the stated value of 589,311 shares of no par value common stock over the new $1 par value thereof. Prior to the merger 5,266 shares of preferred stock and 4,249 shares of common stock held in the treasury were retired.

The 5% preferred stock is redeemable at any time at $100 per share plus accumulated unpaid dividends, and is convertible at the option of the holder into common stock at the rate of 1¾ shares of common stock for each share of preferred stock. Additional capital was increased by $11,986 in 1964 in connection with the conversion of 122 shares of preferred stock into 214 shares of common stock.

Dividends on preferred stock, if not paid, are cumulative only if and to the extent (not exceeding 5% per annum) that earnings are available. On this basis there were no cumulative unpaid dividends at December 31, 1964. If earnings are sufficient, the company is required to set aside annually one half of one per cent of the par value of the authorized preferred stock as a sinking fund for redemption of preferred stock, before dividends are paid on the common stock. There was no cumulative sinking fund obligation as at December 31, 1964.

At December 31, 1963 there were outstanding options granted to certain employees to purchase 30,833 shares of common stock of the company at prices ranging from $6 to $16 per share or an aggregate of $317,000. During the year options for 45 shares were exercised and the $225 excess of the proceeds over the par value of such shares was credited to additional capital. Options for 2,747 shares were terminated during the year and no additional options were granted. At December 31, 1964 there were outstanding options to purchase 28,041 shares at $6 to $16 per share or an aggregate of $288,000 of which options for 24,001 shares were then exercisable at an aggregate of $260,000. Under the present stock option plan, further options for 36,914 shares could be granted to key supervisory personnel at the fair market value at the time of the grant. Options generally become exercisable in instalments over a five-year period and remain exercisable until ten years after the date of the grant.

Note 6—Restrictions on Dividends and Additional Borrowings

The indentures securing the first mortgage bonds, the income mortgage bonds and the guaranteed notes contain

various restrictive provisions under which, at December 31, 1964, the company could not pay dividends on or make purchases of any class of its capital stock. The indenture securing the first mortgage bonds also contains restrictions on additional borrowings.

Note 7—Passenger Service

The Railroad has incurred substantial losses on its passenger service operations for many years. As mentioned on page 3 the Interstate Commerce Commission recently authorized discontinuance of substantially all passenger service. The company has contracted with Massachusetts Bay Transportation Authority for continuation of certain passenger service within a twenty mile radius of Boston under a three-year contract, renewable for two years, starting in January 1965. The contract provides generally that the company will be reimbursed for the excess of passenger service expenses, as defined in the contract, over passenger service revenues and includes options for the Authority to lease or purchase passenger rights of way and passenger equipment at prices to be determined upon exercise of the options.

Note 8—Contingent Obligations and Commitments

In addition to the matters referred to elsewhere in the financial statements and notes, the company had the following contingent obligations and commitments at December 31, 1964:

The company rents approximately 2,400 freight cars and 370 piggyback trailers under long-term leases which expire at various dates to 1970. Current annual rentals under the various leases amount to approximately $920,000. Certain of these leases provide options to renew for substantially lower rentals after the initial terms. The company also rents its general offices under a lease expiring in 1972, renewable thereafter, which provides for a current annual rental of about $280,000.

Together with other participating railroads, the company has guaranteed repayment of certain equipment obligations of Trailer Train Company.

Under certain conditions the company is required to make additional payments under a service interruption insurance policy carried jointly with other railroads.

The company is plaintiff or defendant in numerous lawsuits which, in the opinion of company officials and counsel, will not have a material effect on its financial position. Several pending proceedings are derivative stockholders' suits arising out of actions pending against one present and two former officers and a former director of the company. Recovery, if any, in these actions would inure to the benefit of the company.

OPINION OF INDEPENDENT ACCOUNTANTS

To the Board of Directors and Stockholders of the
Boston and Maine Corporation

We have examined the balance sheet of the Boston and Maine Corporation and its consolidated subsidiaries at December 31, 1964 and the related statements of income and retained income for the year then ended. Our examination was made in accordance with generally accepted auditing standards and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

The depreciation reserves for roadway and structures, accumulated under accounting practices prescribed by the Interstate Commerce Commission as briefly explained in Note 2 of the notes to financial statements, are substantially less than reserves which would have resulted from a systematic method of depreciating the cost of all such properties from the time they were acquired. This deficiency has been augmented by the fact that the reserves which have been provided have been substantially reduced or, for certain classes of assets, eliminated entirely by charges for retirements which have been unusually large in recent years. The roadway and structures accounts still include substantial amounts for branch lines which produce a relatively small portion of the total revenues. We have concluded that neither the current depreciation rates for property for which depreciation is being provided nor the "replacement" accounting method for rails, ties, etc. described in Note 2, provide adequately for retirement losses or obsolescence of the magnitude experienced by this railroad. We have also concluded that it would be impracticable at this time to determine the amount of provisions that would be adequate and reasonable for these purposes.

In our opinion, except for the inadequacy of provisions for depreciation and obsolescence discussed in the preceding paragraph, the financial statements referred to above present fairly the financial position of the Boston and Maine Corporation and its consolidated subsidiaries at December 31, 1964 and the results of their operations for the year, in conformity with generally accepted accounting principles. These principles have been applied on a basis consistent with that applied in the balance sheet and related statements of income and retained income for the preceding year which, with our approval, have been restated to include the accounts of wholly-owned subsidiary companies as explained in Note 1.

Price Waterhouse & Co.

Boston, Massachusetts
February 26, 1965